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SUBJECT: UKRAINE: GOU ANNOUNCES NATURAL GAS PRICE HIKES

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11. (SBU) On April 14, the Ukrainian Cabinet of Ministers (CabMin) published a resolution recommending a 3-5% monthly increase in natural gas prices for individual consumers beginning in May. The move was unexpected, as the media and most energy experts predicted that PM Tymoshenko would not raise household gas prices out of fear that it would greatly decrease her popularity. Tymoshenko, however, opted to make small increases in gas prices each month to muffle the economic impact on consumers. In the same resolution, the CabMin also approved a 4-6% increase in natural gas prices for the chemical industry and 8-12% for all other industrial and public sector consumers. Although the new rates still will not cover costs, energy experts and our contacts at the European Bank for Reconstruction and Development have applauded the move as an important step towards a cost-based energy pricing policy. These experts caution, however, that the CabMin move can only be the first step towards a long-term energy pricing policy based on sound economic principles.

#### Getting Approval for Gas Hikes

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12. (U) The National Electricity/Energy Regulatory Commission (NERC) will need to approve the CabMin recommendation. The Ukrainian press reported that NERC approval is expected within a week, once written justification for the increase is received from Ukraine's state-owned gas and oil company Naftohaz. In accordance with Ukrainian Law on Price Formulation, the NERC will also need agreement from the Federation of Trade Unions of Ukraine before the new rates can go into effect (Note: In 2006 the NERC obtained union approval for a gas price hike only after months of negotiations and delays. End note.) Pending the necessary approvals, NERC officials hope to increase natural gas prices for individual consumers as early as May.

#### Price Categories based on Consumption

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13. (U) The GOU uses a four-category matrix for determining the price for natural gas based on consumption levels. Category 1 pertains to those who consume 2.5 thousand cubic meters (tcm) of gas or less per year. The Ukrainian Ministry of Fuel and Energy estimates that 89% of households fall into this category. The current Category 1 price is \$63 per tcm for those households equipped with gas meters, and \$69 per

tcm for households without meters. If the price hike is approved, these consumers will pay \$76-\$85 per tcm. Since the majority of Ukrainians might be expected to pay \$13-\$16 more for gas, the price increases could become an incentive for installing gas meters throughout the country. At the other end of the matrix, those who consume between 6-12 tcm per year (Category 4) now pay \$235-\$258 per tcm per year. These customers will pay up to \$344 per tcm if the NERC approves the rate hikes. (Note: Since most urban residents obtain heat via district heating and are billed separately for heat and gas for cooking, for most people, the price rises will affect directly only the small amount consumers use for cooking. However, these price rises will certainly affect prices for gas paid by district heating companies and they are sure to pass on these costs to consumers eventually. End Note.)

14. (SBU) Comment. During a time of increased political uncertainty, the GOU has taken an important step in raising natural gas prices to more realistic standards. Years of low prices have created a false sense of security and have discouraged energy efficiency. In addition, gas companies and municipal heating districts have accumulated large debts, leaving them little funding to modernize their networks. The new rates still will not cover costs, and the NERC still needs to approve them, but proposing them during a period of high inflation and political uncertainty sends a strong signal that the current government realizes the days of cheap energy are over. Given the public outcry that accompanied the last wave of utility rate increases two years ago, it is striking how little comment these changes have aroused. There still could be a reaction once consumers get the actual bill, or it could be in the current inflationary environment consumers are less likely to notice the increases. End comment.

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